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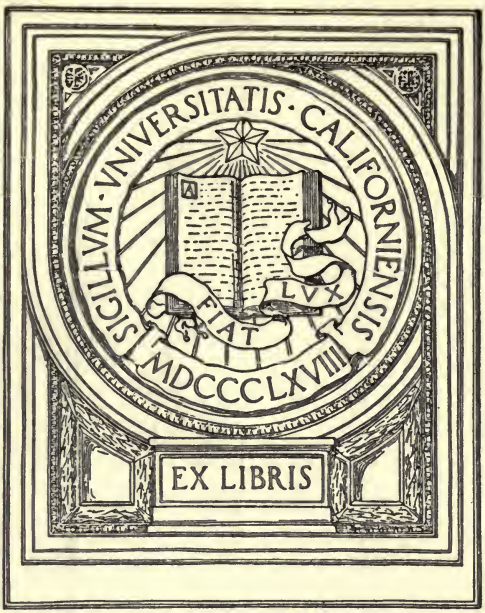
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Money Trust Investigation.

BRIEF ON BEHALF OF THE NEW YORK STOCK EXCHANGE.

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MONEY TRUST INVESTIGATION.

BRIEF ON BEHALF OF THE NEW YORK STOCK EXCHANGE.

The Resolution of the House of Representatives, No. 504, under which the Committee is acting, contains among its recitals one to the effect that it has been charged that certain groups of financiers are "enabled to use the funds and property of the great national banks and other moneyed corporations in the leading money centers to control the security and commodity markets; to regulate the interest rates for money; to create, avert, and compose panics; *to dominate the New York Stock Exchange and the various clearing-house associations throughout the country*, and through such associations and by reason of their aforesaid control over the aforesaid railroads, industrial corporations, and moneyed institutions, and others, and in other ways resulting therefrom have wielded a power over the business, commerce, credits, and finances of the country that is despotic and perilous and is daily becoming more perilous to the public welfare." The resolution authorizes the Committee to investigate and inquire into each of the matters recited in the preamble and among other things to inquire into and investigate *whether and to what extent.* "(*j*) The management and operations of the New York Stock Exchange and the New York Clearing House Association are, or may be, directly or indirectly, dominated, controlled, or otherwise affected by any individuals or groups of individuals who control or are influential in directing the use or deposit of the funds of national banks in the City of New York, or of interstate rail-

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way or industrial corporations, or life insurance companies, and the relations that the New York Stock Exchange and the New York Clearing House bear to such individuals and groups of individuals and to their financial transactions and to our commercial and financial systems and to interstate and foreign commerce; (*k*) Any individual, firm, or corporation, or any one or more groups of such individuals, firms, or corporations, may or can affect the security markets of the country through the New York Stock Exchange, or can create, avert, or compose panics by the control of the use and disposition of moneys in the banks and other moneyed or other corporations that are controlled by such individual, firm, or corporation, or by other means."

These, we believe, are the only parts of the Resolution under which the Committee is acting that refer to the New York Stock Exchange.

The inquiry, so far as the New York Stock Exchange is concerned, has taken a range far beyond the specific questions formulated by the resolution. It could not have been broader if everything pertaining to the constitution, government and management of the Exchange, and the conduct of its members and their relations to whoever has dealings with them, had been involved. This is our excuse for discussing the subject so comprehensively. If the only matter for consideration was, whether any group of financiers or individuals dominates in any degree the Exchange, or through it, the security markets of the country, we should not have deemed it necessary to request the privilege of submitting a brief.

Statement.

The New York Stock Exchange is a voluntary unincorporated association consisting of 1100 members. It may be sued in the name of its president or treasurer, as may any other voluntary unincorporated association, under the pro-

visions of the New York Code of Civil Procedure. The object of the association, as stated in its constitution, is "to furnish exchange rooms and other facilities for the convenient transaction of their business by its members, as brokers; to maintain high standards of commercial honor and integrity among its members, and to promote and inculcate just and equitable principles of trade and business."

The Exchange owns the stock of the Stock Exchange Building Company, which owns the building popularly known as the Stock Exchange. It also owns the securities of the New York Quotation Company, which operates a ticker service, and supplies quotations to members of the Exchange at their offices south of Chambers Street. The principal sources of its income are the dues paid by its members, the amounts received from the New York Quotation Company and from the Western Union Telegraph Company for its quotations, and fees charged by it upon the listing of stocks and bonds.

The Building Company leases to the Exchange the rooms and offices it uses.

The quotations to which we have referred are the quotations of transactions upon the floor of the Exchange collected by its employees as the transactions occur, and immediately transmitted to the operators of the New York Quotation Company and the Western Union Telegraph Company, by whom, respectively, they are sent out over their tickers. The Western Union Telegraph Company furnishes the quotations to members of the Exchange in the City of New York north of Chambers Street, to such other persons and corporations in the City of New York as are approved by the Exchange, and to its patrons in other cities in the State of New York and elsewhere. It is prohibited from furnishing the quotations to any person, firm or corporation engaged in a bucket shop business.

The Exchange does no business unless the matters to which we have referred are considered to constitute "doing business."

The Exchange is not open to the public, no one being allowed to trade on its floor except its own members. All transactions on the floor are transactions between members, who contract in their own names, whether for themselves or on behalf of undisclosed principals. The only people who buy or sell, or transact any other business, on the floor of the Exchange are its members acting for themselves or others.

There are certain rules of the Exchange that affect the contracts which may be entered into between brokers and their principals. In the main, however, the relations between members and their customers do not come within the cognizance of the Exchange so long as there is no violation of equitable principles of trade.

Whether a customer who gives an order to purchase stock is to pay for it in full, or to pay part of the purchase price, borrowing the balance from the broker and leaving the stock with him as security ; whether, and to what extent, the broker may pledge the stock so left with him to secure the money he advances to the customer ; whether a customer who orders a broker to sell stock has already furnished him with the stock to make delivery, or is to furnish him with the stock before the date of delivery, or depends upon the broker to procure for his account the stock with which to make delivery, are all matters that depend upon the contract or arrangement between the broker and his customer. When one broker sells stock to another he does not know whether the purchasing broker is purchasing the stock on margin, or for a customer who has paid for it outright, or for his own account. A broker who buys from another broker does not know whether the selling broker is selling the stock short, or on his own account, or for the account of a customer. A purchase made for a margin account or a short sale is, to all outward appearances, so far as the seller in one case, or the buyer in the other case, is concerned, just like any other purchase or sale.

Just as the Exchange has no direct concern with the contracts between brokers and their principals, so long as there is no violation of equitable principles of trade, it has no direct concern with the terms upon which members borrow money from banks to carry their customers' accounts, or with the collateral pledged to secure the money so borrowed. These are matters that are worked out between the lending banks and the borrowing brokers.

The rules of the Exchange absolutely require that all transactions upon the floor shall be real transactions; and that every contract to purchase or sell shall contemplate actual delivery of the security, and shall be followed by such delivery. The rules do not countenance trading in differences. The usual and regular contract calls for payment and delivery upon the day following the contract (Constitution, page 46).

The only securities dealt in upon the Exchange are those that have been admitted to the Stock List by the officials of the Exchange, who have the power at any time to strike a security from the list, or to suspend dealings in a security upon the floor. *Members of the Exchange, elsewhere than upon the floor of the Exchange, may deal in unlisted securities as freely as any one else.*

The number of issues of stock listed on the Exchange is 555, and the number of bond issues 1,026. The number of issues listed is very small in comparison with the total number of issues of corporations throughout the country, though the aggregate amount of securities listed bears a very much higher proportion to the aggregate amount of all securities, the listed issues including many great issues and comparatively few that are small.

The listing of a security is an assurance that there has been a compliance with the requirements preliminary to listing.

In the early days of the Exchange the requirements for the listing of a security were of minor importance; but they have been gradually made more and more stringent. The purpose

of the requirements is the protection of those who trade in securities listed upon the Exchange.

Every corporation applying to list securities must agree not to dispose of its interests in any constituent company without the consent of its stockholders, and to publish at least once in each year, and submit to its stockholders at least fifteen days in advance of its annual meeting, a detailed statement of its physical and financial condition; an income account covering the previous fiscal year; a balance sheet showing assets and liabilities at the end of the year, and an income account and balance sheet of all its subsidiary companies. A railroad company must state, among other things, the location and route of its road; its total mileage and character of its property; contemplated extensions; total equipment; mortgage liens; other indebtedness or liabilities; its various issues of securities *and application of proceeds;* its income account for the last preceding year, and a balance sheet. Similar requirements are imposed with respect to the listing of railroad bonds and the securities of other corporations. There must also be furnished the resolution of stockholders and directors authorizing the issue; opinion of counsel as to the legality of the issue; the report of a duly qualified engineer covering the actual physical condition of the property as of recent date; and other documents bearing upon the validity of the issue, and the properties which it represents or upon which it is a lien.

Since 1868 thirty days' notice of a proposed increase in the capital stock of a company must be given to the Exchange before such increase may be admitted to dealings.

Securities are not listed until the ownership has become distributed and diversified. Whenever the great bulk of any security has been absorbed by a single interest the security is stricken from the list.

Throughout this brief our use of the term "securities" includes stocks.

Governor Hughes of New York appointed a Commission in December, 1908, of which Mr. Horace White was chairman, to ascertain what changes, if any, were advisable in the laws of the State bearing on speculation in securities and commodities, or relating to the protection of investors, or with regard to the instrumentalities and organizations used in dealing in securities and commodities which are the subject of speculation. This Commission, after an exhaustive study of the subject, made its report in June, 1909.

Among the principal conclusions of the Commission were :

(1) Purchasing securities on margin is as legitimate a transaction as the purchase of any other property in which part payment is deferred.

(2) " Short sales " are perfectly legitimate and of substantial advantage to the community.

(3) The Stock Exchange clearing-house is essential to enable the Exchange to do its necessary and legitimate business.

(4) The Stock Exchange under its present organization, that is, unincorporated, is a more potent instrument for the accomplishment of good than it would be if incorporated.

(5) The statute excepting call loans, secured by warehouse receipts, bills of lading, bills of exchange, and other negotiable instruments, from the operation of the usury laws operates beneficially, and its repeal is inadvisable.

(6) The efforts of the Stock Exchange to control the distribution of its quotations were fully approved, and legislation enabling it more effectually to prevent these quotations from being transmitted to bucket shops was recommended.

The report contained a number of suggestions and recommendations.

It suggested that brokers discourage speculation upon small margins, and that the Exchange use its influence, and, if necessary, its power to prevent members from soliciting and accepting business as a general thing on a less margin than twenty per cent. The Exchange has not taken any action upon

this recommendation, for the reason that it has deemed that such a rigid rule would unduly eliminate the element of personal credit, and for the further reason that, as stated by the Commission itself, "the amount of credit which one person may extend to another is a dangerous subject on which to legislate."

Another suggestion related to the regulation of pyramiding, but this was not practical.

Manipulation was discussed in the report. The impossibility of preventing it altogether was recognized; one form of it was held to be justifiable, and it was suggested that the forms of it which were condemned might be prevented through the exercise by the Exchange of its influence and authority over its members. The views of the Exchange upon the subject of manipulation are set out below.

The report recommended that the Exchange adopt a rule conferring upon the Governing Committee power to decide when a corner exists and to fix a settlement price. This recommendation the Exchange has not acted upon; and it has not appeared to be urgent. There have been only two corners in many years. The last was the Northern Pacific corner in 1901.

A further recommendation was that the books and accounts of the members should be subjected to periodic examination and inspection by the Exchange. The Exchange has not adopted this recommendation further than to authorize its Law Committee to examine into the dealings of any member. There is naturally great opposition on the part of the members to such inquisitorial scrutiny and disclosure of their affairs, which they jealously regard as private and confidential.

The report stated the existing law as to the hypothecation of securities by brokers, and recommended that the Legislature adopt a statute making the wrongful disposition of a customer's securities larceny. This was a recommendation addressed to the Legislature for its action.

It was recommended that the rule forbidding any member

to deal or carry an account for a clerk or employee of another member should be extended to prevent dealing for account of any clerk or subordinate employee of any bank, trust company, insurance company or other monied corporation or bank; and the Exchange promptly adopted the recommendation and amended the rule accordingly.

Another recommendation was the abolition of the unlisted department of the Exchange, and that recommendation has been carried out. In connection with that recommendation the suggestion was made that the Exchange should adopt methods to compel the filing of frequent statements of the financial condition of the companies whose securities are listed, including balance sheets and income and expense accounts, which should be open to public examination under proper rules and regulations; and that in future applications for listing the consideration for capital stock issued should be stated. As to these latter suggestions we call attention to the requirements for listing from which we have quoted at considerable length above. Copies of applications for listing are given to the press and are widely disseminated, and all documents filed by applicants are open to inspection at the offices of the Exchange. To require the filing with the Exchange of frequent statements scarcely seems necessary in view of the detailed statements that are widely published and distributed to stockholders by nearly all the companies whose securities are listed, and such publications as Poor's Manual, Moody's Manual and the Financial Chronicle, which are readily accessible in brokers' offices and elsewhere to those who desire the information that such statements would furnish.

The report recommended the enactment of a statute with respect to false reports of transactions made by brokers to customers which the Legislature has not as yet adopted.

A valuable recommendation related to the unit in trading. The language of the report was: "The Exchange should insist that all trading be done on the basis of a reasonably

small unit, say 100 shares of stock or $1,000 of bonds, but should not permit the offers of such lots or bids for such lots to be ignored by traders offering or bidding for larger amounts. The practice now permitted by allowing bids and offers for large amounts, all or none, assists the manipulation of prices." The Exchange adopted these suggestions in an elaborate system of rules found on pages 76 *et seq.* of the constitution. The scheme of these rules may be shown by a quotation: "If a bid is made for a larger lot of stock above the price at which smaller lots are offered, or if a transaction is made in a larger lot above the price in which smaller lots are offered, such bidder or buyer shall be compelled to buy any or all of the smaller lots which were publicly offered at the time at the lower price up to the amount of the bid for the larger lot." This system of rules, of which the one quoted is part, is drastic and of great effect in preventing manipulation of prices.

The report recommended that the clearing sheets sent by members to the Clearing House be retained instead of being returned to the members at the end of each week. The Exchange considers that these sheets are the property of its members, sent in to the Clearing House for a particular purpose, and that the owners are entitled to them when that purpose has been accomplished. The sheets are only transcripts from the members' books, which are permanent records of the transactions. For these reasons it has not adopted this suggestion.

A further recommendation was that branch offices of brokers should be abolished or effectively regulated. The Exchange has not as yet seen its way clear to altogether abolish them. It has, however, taken firm measures for the effective regulation of such offices and the elimination of their objectionable features.

A further recommendation was that a statute be adopted making misleading advertisements criminal, but the Legislature has not yet adopted that recommendation.

I.

The New York Stock Exchange is not concerned in interstate or foreign commerce, nor do its operations in any respect come within the sphere of federal jurisdiction.

Hopkins vs. U. S., 171 U. S., 578 ; and *Anderson vs. U. S., 171 U. S., 604.*

(a) The first of these cases was a case brought by the United States against the members of a voluntary unincorporated association known as The Kansas City Live Stock Exchange. The purpose of the action was to obtain the dissolution of the Exchange and to perpetually enjoin the members from entering into, or from continuing in, any combination of a like character. The rules of the Exchange prescribed the minimum rates to be charged by its members for selling live stock ; prohibited the members from employing any agent or solicitor except upon a stipulated salary not contingent on the commission earned; limited the number of solicitors that might be employed ; prohibited the members from sending prepaid telegrams or telephone messages giving current quotations ; and also provided that no member of the Exchange should transact business with any person violating any of the rules or regulations of the Exchange or with an expelled or suspended member. It appeared that substantially all the business transacted in receiving, buying, selling and handling live stock at Kansas City was carried on by the members of the Exchange as commission merchants, and that great quantities of this live stock was shipped from other states and was sold at the stock yards to various packing houses, and for shipment to other states.

Mr. Justice PECKHAM, in delivering the opinion of the court, said :

> " As set forth in the record, the main facts are that the defendants have entered into a voluntary association for the purpose of thereby the better conducting their business, and that after they entered into such association they still continued their individual business in full competition with each other, and that the association itself, as an association, does no business whatever, but is simply a means by and through which the individual members who have become thus associated are the better enabled to transact their business ; to maintain and uphold a proper way of doing it ; and to create the means for preserving business integrity in the transaction of the business itself. The business of defendants is primarily and substantially the buying and selling, in their character as commission merchants, at the stock yards in Kansas City, live stock which has been consigned to some of them for the purpose of sale, and the rendering of an account of the proceeds arising therefrom. The sale or purchase of live stock as commission merchants at Kansas City is the business done, and its character is not altered because the larger proportion of the purchases and sales may be of live stock sent into the State from other States or from the Territories. * * *
> * * * The by-laws of the exchange relate to the business of its members who are commission merchants at Kansas City, and some of these by-laws, it is claimed by the Government, are in violation of the act of Congress, because they are in restraint of that business which is in truth interstate commerce. That one of the by-laws which relates to the commissions to be charged for selling the various kinds of stock, is particularly cited as a violation of the act. * * * The commission agent in selling the cattle for their owner simply aids him in finding a market ; but the facilities thus afforded the owner by the agent are not of such a nature as to thereby make that agent an individual engaged in interstate commerce, nor is his agree-

ment with others engaged in the same business, as to the terms upon which they would provide these facilities, rendered void as a contract in restraint of that commerce. * * * * * * If charges of the nature described do not amount to a regulation of interstate trade or commerce, * * * it would for a like reason seem clear that agreements relating to the amounts of such charges among those who furnish the privileges or facilities are not in restraint of that kind of trade. * * *

* * * The services of members of different stock and produce exchanges throughout the country, in effecting sales of the articles they deal in, are of a similar nature. Members of the New York Stock Exchange buy and sell shares of stock of railroads and other corporations, and the property represented by such shares of stock is situated all over the country. Is a broker whose principal lives outside of New York State, and who sends him the shares of stock or the bonds of a corporation created and doing business in another State, for sale, engaged in interstate commerce? If he is employed to purchase stock or bonds in a like corporation under the same circumstances, is he then engaged in the business of interstate commerce? It may, perhaps, be answered that stocks or bonds are not commodities, and that dealers therein are not engaged in commerce. Whether it is an answer to the question need not be considered, for we will take the case of the New York Produce Exchange. Is a member of that body to whom a cargo of grain is consigned from a western State to be sold engaged in interstate commerce when he performs the service of selling the article upon its arrival in New York and transmitting the proceeds of the sale less his commission? Is a New Orleans cotton broker who is a member of the Cotton Exchange of that city, and who receives consignments of cotton from different States and sells them on 'change in New Orleans and accounts to his consignors for the proceeds of such sales less his commission, engaged in interstate commerce? Is the character of the business altered in

> either case by the fact that the broker has advanced moneys to the owner of the article and taken a mortgage thereon as his security? We understand we are in these queries assuming substantially the same facts as those which are contained in the case before us, and if these defendants are engaged in interstate commerce because of their services in the sale of cattle which may come from other States, then the same must be said in regard to the members of the other exchanges above referred to. We think it would be an entirely novel view of the situation if all the members of these different exchanges throughout the country were to be regarded as engaged in interstate commerce, because they sell things for their principals which come from States different from the one in which the exchange is situated and the sale made.
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> "The theory upon which we think the by-law or agreement regarding commissions is not a violation of the statute operates also in the case of the other provisions of the by-laws. The answer in regard to all objections is, the defendants are not engaged in interstate commerce."

Anderson vs. United States, 171 U. S., 604, was another case brought by the United States under the Sherman Act, the purpose of the action being the dissolution of the Traders' Live Stock Exchange, an unincorporated association. The members of the Exchange were not commission merchants as in the Hopkins case, but traders. The rules of the exchange provided that it would not recognize any yard trader unless he was a member of the Exchange; that two or more parties trading together as partners must both be members of the Exchange; that no member of the Exchange should employ any person to buy or sell cattle unless such person held a certificate of membership in the Exchange; and that no member of the Exchange should be allowed to pay any other buyer or salesman any sum of money as a fee for buying

cattle from, or selling to, a party not a member of the Exchange. Mr. Justice PECKHAM in delivering the opinion of the Supreme Court said:

> " In the view we take of this case we are not called upon to decide whether the defendants are or are not engaged in interstate commerce, because if it be conceded they are so engaged, the agreement as evidenced by the by-laws is not one in restraint of that trade, nor is there any combination to monopolize or attempt to monopolize such trade within the meaning of the act.
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> " From very early times it has been the custom for men engaged in the occupation of buying and selling articles of a similar nature at any particular place to associate themselves together. The object of the association has in many cases been to provide for the ready transaction of the business of the associates by obtaining a general headquarters for its conduct, and thus to ensure a quick and certain market for the sale or purchase of the article dealt in. Another purpose has been to provide a standard of business integrity among the members by adopting rules for just and fair dealing among them and enforcing the same by penalties for their violation. The agreements have been voluntary, and the penalties have been enforced under the supervision and by members of the association. The preamble adopted by the association in this case shows the ostensible purpose of its formation. It was not formed for pecuniary profits, and a careful perusal of the whole agreement fails, as we think, to show that its purpose was other than as stated in the preamble. In other words, we think that the rules adopted do not contradict the expressed purpose of the preamble, and that the result naturally to be expected from an enforcement of the rules would not directly, if at all, affect interstate trade and commerce." * * *

In *Ware & Leland vs. Mobile County, 209 U. S., 405*, it was held that contracts for sales of cotton for future delivery,

which do not obligate interstate shipments, were not subjects of interstate commerce, and that brokers in Mobile taking orders for the purchase and sale of cotton for future delivery to be executed upon the New York and New Orleans Cotton Exchanges were not engaged in interstate commerce.

In *New York, ex rel. Hatch vs. Reardon, 204 U. S., 152*, the Supreme Court passed upon the question whether the Stock Transfer Tax of New York was or was not a burden upon interstate commerce. Speaking of a sale made in the State of New York of stock in the Southern Railway Company and of stock in the Chicago, Milwaukee and St. Paul Railroad Company, the Court said: "*There is not a shadow of a ground*" *for calling these transactions interstate commerce* (page 161).

(b) It follows from these cases that Congress has no power with respect to the matters affecting directly or remotely the Exchange concerning which testimony was elicited; for instance as to whether such a body as the Exchange should be incorporated; the number of its members; the minimum rate of commission; the rules governing the members and their transactions on the Exchange; the exercise of its disciplinary powers over members; the listing of securities and the striking of securities from the list; marginal purchases; manipulation, and short sales. All these matters are clearly beyond the province and jurisdiction of Congress.

(c) The agreement between the Exchange and the Western Union Telegraph Company, under which the Telegraph Company may not deliver quotations to members of the Exchange at their offices south of Chambers Street, but may deliver such quotations to members in the City of New York north of Chambers Street, and to any non-members of the Exchange in the City of New York if approved by the Exchange, and to persons outside the City of New York provided they are not engaged in conducting bucket shops, is not an arrangement that restrains interstate

commerce or any other sort of commerce. The Exchange, as the owner of quotations, prescribes the persons to whom the public service corporation transmitting the quotations may deliver them. The right exercised by the Exchange is similar to the right exercised by every one who sends a telegraph message.

In Board of Trade vs. Christie Grain and Stock Company, 198 U. S., 236, the Chicago Board of Trade sought successfully to enjoin certain of the defendants from obtaining and using its quotations. The plaintiff's quotations were furnished to a Telegraph Company under an arrangement very similar to the arrangement between the Exchange and the Western Union Telegraph Company, the Telegraph Company agreeing not to furnish them to any bucket shop or place where they might be used as a basis for bets or illegal contracts. The Supreme Court said as to the claim that this arrangement was in restraint of trade (page 252): "*But so far as these contracts limit the communication of what the plaintiff might have refrained from communicating to any one, there is no monopoly or attempt at monopoly, and no contract in restraint of trade, either under the statute or at common law.*"

In the case of the *Commercial Telegram Company vs. Smith, 47 Hun, 494*, the claim was made that the Stock Exchange had no right to exclude the Commercial Telegram Company from the privilege of collecting quotations on its floor for transmission to outsiders. This was held to be erroneous. Mr. Justice Van Brunt, writing the opinion of the Court, said (pages 505 and 507):

> "The claim that the Stock Exchange has no right to exclude the Commercial Telegram Company from its floor upon the ground of public policy evidently proceeds upon an entirely erroneous theory. The Exchange is a private association; it has the right to admit to its

floor whom it pleases ; it obtains nothing from the State except that protection which the law affords to every citizen ; it has sought no special privilege and obtained no special powers. It is, therefore, just as much the master of its own business and of the method of conducting the same as any private individual within the State. It may make public the transactions which occur within its walls or it may refuse all information in respect theroto. No matter which course is pursued, so long as it violates no law it has a right to conduct its business as it pleases. * * * The New York Stock Exchange has asked nothing from the people of the State, except that which is granted to every citizen ; it has no special privileges under the law, it has no special rights, and the people therefore have no right to interfere in the transaction of its business to any greater extent than they have in that of any individual."

In *Wilson, as President of the Consolidated Exchange, against Smith, 18 N. Y. State Rep., 78*, Mr. Justice BROWN said at pp. 84, 85 :

" The New York Stock Exchange is not a corporation ; it is a voluntary association of individuals engaged in business as brokers in stocks, bonds and other securities.

" It is not the outgrowth of any public demand, serves no public interest, has sought no special privileges or power, and has asked and obtained nothing from the State, except that protection which the law affords every citizen and exists solely for the purpose of affording its members facilities for the transaction of their individual business. * * *

" In the exercise of its ordinary functions it does not usually engage in any business except such as are incidental to the furnishing proper and convenient facilities to its members. It is not interested in the business transacted between its members, and makes no sales or purchases of any securities dealt in within its walls, and is under no obligation to acquire any in-

formation as to any transactions taking place there, or to ascertain the prices of any securities therein bought or sold.

"In all this, there is plainly no public service, and in accomplishing the object and purpose of its organization no public duty. * * * So that in all business transactions on the floor of the Exchange, between its members there is no public service and no public duty, and no obligation rests upon any of the members of the Exchange to make known any of the details of their transactions with other members, and that with respect to sales of bonds, stock and securities there is the same immunity from public inspection as exists in all branches of mercantile business. * * *

"The Exchange, as an association, stands in no different relation to the public in respect to their transactions than do individual members. Whatever it does, it does by their direction. Its acts express simply the will of the majority. If there is any public duty growing out of the business of dealing in stocks and bonds, the obligation is greater upon the broker who sells than on the Exchange. The Exchange is but the agent of its members. Whatever information it possesses it holds in trust for its members. Yet any member may refuse to make public his sales or purchases. How then can the Exchange be compelled to make public that member's business which he has a right to keep private? * * * (p. 87).

"So long as he violates no law and does not interfere with the reciprocal rights of others, every man may do what he will with his own; he may engage in any lawful business or occupation and he may sell his own goods or refuse to sell to whomsoever he chooses. The obligation of the stock exchange with reference to the transactions between its members, arising from the fact that it collects and sells the quotations, can be no greater than the obligations resting on any other merchant to make known the price of his goods."

(d) The provisions of the constitution of the Exchange to the effect that the proceeds of the transfer of a membership

shall be applied first to the payment of debts due to fellow members are not in conflict with the provisions or policy of the Bankruptcy Acts. *Hyde vs. Woods, 94 U. S., 523*, dealt with the provisions of the constitution of the San Francisco Stock and Exchange Board, a voluntary association. The constitution of the Board provided that " in sales of seats for account of delinquent members the proceeds shall be applied to the benefit of the members of this board exclusive of outside creditors, unless there shall be a balance after payment of the claims of members in full." The Supreme Court said with respect to article 15, page 525 :

> " There is no reason why the stock board should not make membership subject to the rule in question, unless it be that it is a violation of some statute, or of some principle of public policy. It does not violate the provision of the bankrupt law against preference of creditors, for such a preference is only void when made within four months previous to the commencement of the bankrupt proceedings. Neither the bankrupt law nor any principle of morals is violated by this provision, so far as we can see. A seat in this board is not a matter of absolute purchase. Though we have said it is property, it is incumbered with conditions when purchased, without which it could not be obtained. It never was free from the conditions of article 15, neither when Fenn bought, nor at any time before or since. That rule entered into and became an incident of the property when it was created, and remains a part of it into whose hands soever it may come. As the creators of this right—this property—took nothing from any man's creditors when they created it, no wrong was done to any creditor by the imposition of this condition." * * *
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> " It is said that it is against the policy of the bankrupt law, against public policy, to permit a man to make in this or any other manner a standing or perpetual appropriation of his property to the prejudice of his general creditors ; and that it is to this point that the nu-

merous authorities of counsel are cited. They all, however, relate to cases where a man has done this with property which was his own,—property on which he himself imposed the direction, or the incumbrance, which impeded creditors.

"It is quite different where a man takes property by purchase or otherwise, which is subject to that direction or disposition when he receives it. It is no act of his which imposes the burden. It was imposed by those who had a right to do it, and to make it an accompaniment of any title which they gave to it."

II.

The organization and constitution of the Exchange are admirably adapted to facilitate the convenient transaction of the business of its members, to prevent wrong, and to maintain high standards of commercial honor and integrity.

The constitution declares that the object of the Exchange "shall be to furnish exchange rooms and other facilities for the convenient transaction of their business by its members, as brokers; to maintain high standards of commercial honor and integrity among its members; and to promote and inculcate just and equitable principles of trade and business."

The Governing Committee has always been composed of men of experience and high standing. It consists of forty members, ten of whom are elected every year. The re-election of its members has been the rule, to retain the benefits of their knowledge and experience and assure courage and continuity in the policies of the management. A more stable and efficient form of government could not be devised.

Article XVII., Sec. 2, provides that "a member adjudged * * * to be guilty of fraud or of fraudulent acts shall be expelled." Sec. 6 of the same Article provides that "a member who shall be adjudged * * * guilty * * * of any conduct or proceeding inconsistent with just and equitable principles of trade may be suspended or expelled;" Sec. 7, that a member may be required to submit to the Governing Committee or to any Standing Committee such portion of his books or papers as are material to any matter under investigation; and Sec. 8, that a member may be suspended for any act determined to be contrary to the interests or welfare of the Exchange.

Puts and calls are prohibited (page 48).

Fictitious transactions are forbidden; (page 48) *and this prohibition includes "matched" orders and "wash" sales.*

Resolutions of March 30, 1910 (pages 76 to 79), provide that "all bids and offers on larger lots shall be considered to be for any part thereof in lots of 100 shares or of multiples thereof", so that any man who offers to buy or sell a larger block of stock must take and pay for, or must sell and deliver, smaller blocks which are offered at lower prices or bid for at higher prices.

By Article XI., Sec. 1, provision is made for the arbitration of disputes between members; by Article XXX for immediate settlement of disagreements over the terms of a contract; and by Article XI., Section 1, Par. 10 for the determination of questions arising upon the settlement of contracts, and practically for the prompt disposition of every question which might embarrass the expeditious transaction of business.

Any member who fails to comply with his contracts, or is insolvent, is at once automatically suspended. (Article XVI.)

Members are forbidden to take or carry speculative accounts in which a clerk of the Exchange, or of a member of the Exchange, or of a bank, trust company, banker or insur-

ance company, is directly or indirectly interested, unless the written consent of the employer has been first obtained. (page 84)

Every member of the Exchange is required to use due diligence to learn the essential facts relating to every account accepted by himself, or by his clerks or representatives. (page 84)

If any customer of a member chooses to bring before the Arbitration Committee a claim against a member, the member is bound by the award of that Committee. Any complaint of alleged wrongdoing asserted by a non-member against a member of the Exchange is promptly dealt with by the appropriate Committee.

These are only a few among the body of rules which has been established as the result of long experience and serious thought. We believe that no better system of rules could have been devised. They are a growth, and reflect the best efforts of the Governors to accomplish the objects of the Exchange as expressed in its constitution with due regard to changing conditions. They regulate a business of vast dimensions and great complexity; and that they should not obstruct it in any of its legitimate phases is the essential thing. They may not prevent some sporadic transactions and operations that cannot be justified; but no system of rules can be devised that will do so. The most that can be expected is, that they go as far in that direction as is consistent with the free and unobstructed transaction of legitimate business.

The rules making acts contrary to just and equitable principles of trade a ground for expulsion enable the Exchange to hold its members to a standard of business integrity far higher than the law does, or could, require. A member may be expelled for doing that which, according to the standard of the most honorable of his own business associates, is deemed contrary to fair dealing, irrespective of the question whether or not it amounts at law to fraud or positive wrongdoing.

He may be punished for reckless and unbusinesslike conduct, and even for errors of judgment. In all his transactions he has to conform to a standard which the law does not undertake to prescribe. Whatever he does has to be in accordance with "just and equitable principles of trade"—a standard unknown to any system of law. Whether any particular act of his violates those principles is determined, not by an outside body of laymen like a jury and the application of technical rules of evidence ; but by a select body of members of the Exchange, chosen to uphold just and fair dealing, who ascertain the facts with businesslike directness, and who are empowered to expel, which is the ruin of a man's career as a broker, or to suspend, which is a deep humiliation. These rules are an illustration of the disciplinary efficiency of the Exchange.

The rules requiring the completion of any sale and purchase on the Exchange by actual delivery and payment on the day after the transaction, and prohibiting fictitious transactions, "matched" orders and "wash" sales, are illustrations of the provisions made to assure that every purchase and sale shall be a real and genuine transaction. Many think that that is as far as rules can go in fixing the regularity of purchases and sales. The region beyond is the region of the motives of men, and how far regulation can extend into that region, if at all, without obstructing legitimate business, is one of the most difficult of problems. But the efficacy of the existing rules, providing that every transaction shall be a real and genuine purchase and sale, in assuring the legitimacy of the great bulk of the business transacted on the Exchange is unquestionable.

In the conduct of this mass of business there is seldom a dispute between the contracting parties which is not immediately settled through the instrumentalities of the Exchange without resort to litigation. There is no business community in which the obligations of good faith and fair dealing are observed more strictly than by the members of the

Exchange. This is proverbial. The repudiation of a contract is practically unknown. Every day thousands of transactions involving millions of money are closed without a hitch. That anything else could happen on the Exchange is almost inconceivable to its members. A body which has developed such a high sense of honor among its members must be sound in its principles and administration.

The fidelity of the members of the Exchange to their customers is attested by the fact that, notwithstanding the unusual risks and temptations of the business, only seventy-eight failures have occurred in the last thirteen years, or six a year. Thus the annual ratio of members who failed during that period to the total membership was slightly more than one-half of one per cent.; and half of those who failed settled with their creditors. It seems scarcely probable that any rules could be devised to produce a better showing.

Without further argument or illustration we feel that we are thoroughly justified in asserting that the constitution, government and administration of the Exchange are sound and efficient. They are not perfect; no human things are. They may be criticised, which is also the fate of all things human. That they should be denounced is intolerably unfair and unjust. We can only assume that there is room for improvement; but that is a work to be undertaken calmly and deliberately, and with a full appreciation of the fact that great interests are at stake which will not bear rough or arbitrary treatment, and of the fact that capable, experienced and high-minded men have been long at work on what problems there are seeking to solve them wisely and sanely. Any other process of change and improvement is fraught with grave dangers. It is too often the case with legislative remedies, originating in excitement and agitation, that they produce just the opposite effect to what was expected and make things worse than they were. The history of legislation more than bears out the truth of this statement.

III.

No good purpose would be accomplished by the incorporation of the Exchange. On the contrary, the substitution of public control for the control exercised by the Exchange over its members would be detrimental to the public interest. To force incorporation would be unjust.

We beg to refer the Committee to the portions of the report of the Hughes Commission and of the statement of the officials of the Exchange submitted to the Commission that bear on that subject.

(1) The principal argument for incorporation is that a business of the volume and public importance of the business transacted upon the Exchange should be subject to public regulation and control; that incorporation would involve such public regulation and control; and that thereby certain evils supposed to result from, or to be incidental to, dealings in stocks on the Exchange would be prevented or diminished.

Let us analyze these propositions. It is easy to talk about incorporation and what it would accomplish; about public regulation and its virtues; but what is incorporation and what is public regulation? what agencies do they bring into play to supplant those now in force? what is gained or lost? A calm consideration of these questions is necessary if they are to be settled on their merits rather than by mere clamour.

(1) What is incorporation?

The Exchange is now a voluntary association of men engaged in the business of buying and selling stocks and other securities on their own account and as brokers for others, and who deal with each other. They formed this association as a convenience for themselves in dealing with each other. They admit to it whom they see fit and deem proper associ-

ates. No one has a right to be admitted any more than a man has a right to force himself into an ordinary partnership. It is rather a startling proposition that such a body can be coerced into turning itself into a corporation, if anything can be startling in these days when the average man devotes such time as he can spare from denouncing the shortcomings of public authorities to urging the extension of their powers and activities. But let us suppose that it can be done. What follows? The Cotton Exchange and the Produce Exchange are incorporated. The public, however, exercises no control over the business conducted upon these Exchanges; and as such they are substantially as free from public regulation as the Stock Exchange, or as the Consolidated Exchange, which is also unincorporated. Their charters define the purposes for which they are incorporated and the powers they may exercise for the accomplishment of those purposes. So long as they do not exceed the powers which their charters confer upon them they are the sole judges of the manner in which these powers shall be exercised; and their acts done in the exercise of these powers are not subject to review by the courts or by any other public authority. (*People ex rel. Johnson vs. New York Produce Exchange, 149 New York, 401; Haebler vs. New York Produce Exchange, 149 New York, 414*).

Hence incorporation of the same kind as the Cotton and Produce Exchanges would accomplish nothing so far as public regulation is concerned. Let us pursue this a little further.

Following the precedent of the incorporated Exchanges mentioned the charter of the Stock Exchange would declare its purposes and invest it with the powers necessary to carry them out. Among these powers would be the power to make by-laws governing the transaction of business on the Exchange, and the power to discipline its members for conduct in violation of the rules or the law. It would be the discretion of the Exchange that would govern in the exercise of these powers, and no

court or public official could interfere with the exercise of that discretion unless a power was abused or trangressed. No new power of direction, control and government would be introduced by incorporation on this model, which is the model of the law as it exists to-day. Evidently then something more is intended by the advocates of further control or regulation.

(2) What then is public control or regulation and what does it involve?

(*a*) It may be assumed that one element is that the Legislature will take a hand in framing the rules for the conduct of the business, and particularly in prohibiting specific acts and practices, such as, for instance, improper manipulation.

But incorporation is not necessary to the enactment and enforcement of such prohibitions. Members of the Exchange are just as amenable to the laws of the land as other persons, and a prohibited act is just as unlawful on the Exchange as anywhere else. If, for instance, the Legislature succeeds in defining improper manipulation, and enacts a law prohibiting it, that law is just as applicable to transactions on the Exchange as a voluntary association as it could be if it were incorporated. Incorporation is not necessary to make such a law, or any other general law, applicable to transactions on the Exchange. Hence the necessity of regulation which can be accomplished by such general laws is not an argument for incorporation. There are such general laws in force, and no one ever dreamed that they were not applicable to transactions on the Exchange because it was not incorporated.

As to framing the delicate and intricate rules for the conduct of the business on the Exchange, which is the fittest body, —a legislature changing from year to year, or the Governing Committee of the Exchange, composed of men having an intimate knowledge of the business, selected for their ability, experience and character, and deeply interested in its orderly

conduct and the reputation of the Exchange? That question answers itself.

(b) We assume that another element of this public control and regulation is supervision by some State authority of the transactions on the Exchange, of the disciplining of members, and of their solvency. This would require a small army of paid inspectors and accountants. As the Exchange does not buy or sell it has no records. The only records of the daily transactions on the Exchange are the books and papers of the members. The transactions are constant and innumerable. Is there to be a body of public officials constantly examining the books and papers of hundreds of brokers to ascertain whether they have been guilty of violations of the rules or the law for the purpose of initiating discipline or legal proceedings? Such a system of espionage is impracticable, and if it were not impracticable it would be intolerable.

The same is true of the examination of the books of hundreds of brokers to ascertain their solvency from day to day. If such a thing were practicable, what occasion is there for it considering the small percentage of failures which occurs, as has been shown? That it is not practicable is obvious to any sensible man. Surely it is not necessary for us to show that there is no analogy between such conditions and the periodical examination of banks by examiners.

Public regulation and control of the Exchange when analyzed is without any substance. It is something without any useful purpose, practicability or meaning. As a cure for any evils that exist it is without efficiency or merit. The demand for it, however honest, has no real foundation, and serves only to mislead and create prejudice and distrust. The last thing thought of is to define it as a specific measure that can be put in operation to accomplish specific results; and until that is done it is not entitled to serious consideration. So far it has not been done, and the blind faith in it is part and

parcel of the current belief that whatever there is of wrong or evil in business is curable somehow or other by the intervention of the State.

(3) Incorporation has in it the seeds of demoralization. We firmly believe that its probable consequences will be the debasement of the Exchange instead of the reform of evils, which, if they exist at all in any real sense, are grossly exaggerated.

There are various directions in which incorporation is more than likely to be baleful.

(a) A vital function of the Exchange is the exercise of its disciplinary power over its members, which has to be taken in connection with the standard of conduct it imposes and enforces. That standard is, as we have seen, that the conduct of its members in their transactions must conform to just and equitable principles of trade. A private association may impose such a standard upon its members though it is higher than the standard prescribed by law. The Exchange enforces its own rules and standards through its Governing Committee. Written charges are preferred; the member is given an opportunity to answer; and then there is a full hearing before the Governing Committee, at which the member is present to give his own version of the facts. When a member is expelled or suspended the penalty becomes operative immediately; and the Courts do not interfere if it appears that the charge concerns a violation of an existing rule; that there is evidence to support it; and that the Governing Committee acts in good faith in its determination.

In *White vs. Brownell, 2 Daly, 329*, Mr. Justice VAN VORST said:

> "As this association is not organized in pursuance of any statute, nor the terms of membership fixed by the principle of the common law, it follows that the agreement which the members make among themselves

on the subject, must establish and determine the rights of the parties on the subject. The constitution of the association, and its laws agreed upon by the members, contains all the stipulations of the parties, and is the law which should govern. * * * No person is entitled to membership, in the Open Board of Brokers, except he is approved by the appropriate committee, voted for by the board, and shall agree to, adopt, and affix his name to the constitution, and, having done this, each member should stand by this contract. * * *

"The Court must regard the Constitution and laws of this board as the contract by which all the members are bound. The Court cannot make any other contract for the parties than they have solemnly made for themselves."

"Such an organization may prescribe the conditions upon which persons will be admitted to membership, as well as the conditions upon which the continuance of membership will depend, * * * Voluntary bodies of this kind will be held to the fair and honest administration of the rules which are in force when any proceeding is instituted against a member; but where a member is expelled in conformity with the rules, and the proceedings are regular and in good faith, it is final, and no judicial tribunal can interfere."

See, also,

Lewis vs. Wilson, 121 N. Y., 284.

Neukirch vs. Keppler, 56 App. Div., 225 (affirmed without opinion by the Court of Appeals, 174 N. Y., 509).

Young vs. Eames, 78 App. Div., 229 (affirmed by the Court of Appeals without opinion, 181 N. Y., 542).

It is a remarkable fact, testifying to the ability and high character of the Governing Committee, that its action in expelling or suspending a member has always been sustained by the courts.

If the Exchange were incorporated would its charter provide for a judicial review on the merits of the determinations of the Governing Committee expelling or suspending a member? If it did not, how long would it be before its charter was amended to include such a provision? It is easy to realize the sentimental force of an agitation for such a provision industriously worked up by men under charges or who had been expelled. One can hear the appeal that a man should not be deprived of his membership without his day in a court of law. The issue of such an appeal is not doubtful.

A judicial review would inevitably sap the disciplinary power of its vitality. Every case would be taken into court, and injunctions and stays of proceedings would stop the execution of the determination of the Governing Committee until the last court of review was through with the case. That would take two or three years, and in the meantime the member would continue his activities on the Exchange. Then there is no comparison between the competency of the Governing Committee as a tribunal to try such cases, with its experience and intimate knowledge of the business and its appreciation of the effect of the acts with which the member is charged, and the competency of the ordinary judge without that experience, knowledge and appreciation. If the court differed with the Governing Committee the member would retain his membership though his conduct had been condemned by his associates. Discipline could not possibly be maintained under such conditions. Moreover the inevitable tendency of this power of review by the courts would be to substitute the standards of the law for the more stringent standards of the Exchange. "Just and equitable principles of trade" would come to be what the courts declared them to be, and the analogies that the courts would apply would be derived from that body of legal rules which defines what acts are wrongful in the sense that they are a sufficient basis for an

action for the recovery of damages. The Exchange applies the layman's view of what are just and equitable principles of trade, and is governed more by moral than strictly legal considerations. There is a wide difference in such matters between what is just from the point of view of honorable conduct and what is just from the point of view of legal rights. A man may have a real grievance against another in a business matter without there being the slightest violation of his legal rights. It is on this principle that members of the Exchange have been punished by expulsion or suspension for acts contrary to the morals of business, but without any taint in them of wrong in a legal sense.

These are the reasons for our statement that a full judicial review of the disciplinary judgments of the Governing Committee would lower the whole tone of the Exchange and radically impair its standard of just, equitable and honest dealing. Any movement which deteriorates its standards is inimical to the public interests to a degree commensurate with the vast dealings of which it is the center and with the function it performs.

(*b*) Judicial review is also inappropriate with respect to the listing of securities and striking securities from the list. Those are matters that are now entirely subject to determination by a highly qualified committee of the Exchange. The questions they involve are of a business and not a legal character, and require for their determination sound business judgment rather than the judicial cast of mind or legal methods. Imagine a judicial tribunal taking evidence as to whether a security should be listed or stricken from the list and then deciding the matter as a legal question. The function of a judge is to apply the law of the land to disputes between parties over their legal rights. It is not his function to determine what are proper securities to be dealt in on a stock exchange. And if it be suggested that this function should be

conferred, not upon the courts, but upon State officials, who will maintain that they would be more competent to decide such questions than the members of a committee of the Exchange selected because of their standing, experience and qualifications? Who would prefer, as to such a matter, the judgment of State officials who come and go to that of men whose qualifications are those of genuine experts?

(c) The comprehensive objection to incorporation is that it converts a self-governing body into one subject to external control in all the ramifications of its functions and operations. Responsibility is weakened by the commingling of internal and external authority, and responsibility is essential to integrity and efficiency. It is not the case of a trust relation involving money or property, like a bank or insurance company, with respect to which regulation has a distinct function and use. State control of a body like the Exchange inevitably impairs its own responsibility for the conditions which exist at any time. Divided between two regulative powers or authorities it is bound to be weak and inefficient.

Moreover, with incorporation the element of permanence will disappear. Every year there will be efforts to amend the charter inspired by every sort of motive, good and bad. The Exchange is peculiarly a target for such attacks. It is sure to be continually embroiled with proposed legislation and distracted by legislation that has been enacted. Members as well as non-members with grievances, however imaginary or the result of their own negligence or imprudence, will rush to the legislature with amendments to still more enfeeble its government. These are the conditions which will prevail beyond any sort of doubt; and they will surely weaken its government, and eliminate from it many of the strong and able men who devote their time and energy to it out of a spirit of true devotion to its best interests. The office of Governor will cease to be the honor that it is; the membership of

the Governing Committee will be less constant ; and the administration of the affairs of the Exchange, assailed and harrassed by outside interference, must sink to lower levels.

(d) There is not the excuse for State control that the business done on the Exchange is a monopoly.

There is no monopoly if securities are marketable though not listed upon the Exchange. That they are appears quite clearly from the testimony of Mr. Mabon (pages 372-3, 405-6), and Mr. Pomroy (pages 489, 492, 494, 496), which is confirmed by the fact that the number of corporations in the United States is upwards of two hundred and seventy-two thousand (272,000) ; that the aggregate amount of the stock of these corporations is fifty-eight billion (58,000,000,000) dollars ; that their bond issues aggregate thirty billion (30,000,000,000) ; and that there are listed on the Exchange five hundred and fifty (550) issues of stock, having an aggregate par value of thirteen billion (13,000,000,000) dollars, and one thousand and twenty-eight (1,028) issues of bonds having an aggregate par value of thirteen billion (13,000,000,000). Thus it is evident that stocks and bonds can be and are sold to an enormous extent elsewhere than upon the Exchange.

Any well known stock can be readily disposed of, and money borrowed upon it, although not listed on the Exchange. Transactions in such stocks take place all the time in great volume elsewhere. Brokers interested in particular stocks are known to other brokers, and there is no trouble whatever in finding a market through them for non-listed stocks. Bonds are dealt in outside the Exchange to an amount exceeding many fold the transactions in bonds upon its floor.

Bankers, brokers and dealers, not the Exchange, are the essential mediums of the purchase and sale of securities. In the case of inactive securities the machinery of private sale through brokers is fully sufficient to bring buyers and sellers together readily and without inconvenience. In the case of a security that is active, that is to say, where there are many

people constantly offering to sell and offering to buy, so that the trading is in large volume, the facilities afforded by the Exchange are a great convenience in bringing buyers and sellers together, but they are not indispensable. If the security is not listed on the Exchange, the buyers and sellers, or th ir brokers, will find a common meeting place elsewhere.

Listing upon the Exchange imparts to a security a peculiar value, *not because such listing is essential to its marketability or availability as collateral, but because it makes it more acceptable to those to whom it is offered for sale or as collateral.* It is more acceptable because the listing implies that it meets the requirements prescribed by the Exchange; because the Exchange has built up a great and enviable reputation ; and because a great proportion of the people who purchase and sell securities deal through members of the Exchange owing to the standing which membership gives.

These circumstances, however, do not imply that the Exchange is an exclusive market.

(4) To coerce the Stock Exchange to accept incorporation would be unjust. It has "asked and obtained nothing from the State except that protection which the law affords to every citizen" *(Wilson vs. Smith, 18 N. Y. State Rep., 78).* As a voluntary association for the transaction of business by its members under its rules it was formed more than three quarters of a century ago, and has since grown and developed, without contravening any law of the state or any principle of public policy. Membership has come to have a large pecuniary value and represents a considerable investment by every member. For many years the consideration for a seat has ranged between fifty and ninety thousand dollars. Every member has made this investment in the Exchange as a self-governing voluntary association, and in the expectation that it would continue to control and manage its own affairs. The State cannot by a direct enactment incorporate

the Exchange without the consent of its members, because any such enactment would be unconstitutional. To accomplish that result indirectly through coercion and in disregard of the wishes of its members, if that can be done as it seems to be assumed it can be, would be a radical interference with their rights and privileges existing under the sanction of the law, the pecuniary consequences of which they will have to bear. The conversion of membership in this voluntary association based on a contract, which the State cannot alter or impair, into membership in a corporation under a charter subject in every detail to the plenary legislative power of the State would be followed by an enormous shrinkage in its pecuniary value. Is that just? To ask this question is to answer it. It is confiscation pure and simple.

(5) We assert that no regulation whatsoever is within the power of Congress. But we are far from asserting that the State is without any power of regulation. That the State may legislate with respect to transactions, such as improper manipulation, is unquestionable. How effectively it can legislate as to such matters is another question. Hopes and expectations in that direction are apt to be in the inverse ratio of accurate knowledge and experience. It is a regulation interfering with, and diminishing, the responsible self-government of the Exchange that we argue against as detrimental in an incalculable degree as well to the interests of the public as to those of the Exchange. There is no justification for the assertion that that government is or has been, blind, sordid or unintelligent. The history of the Exchange as a whole is conclusive evidence to the contrary. It would not stand at the head of the Exchanges of the world if those had been its characteristics. It is in the nature of things that there should have been sporadic evils; but an institution is to be judged by its normal conditions and not by abnormal incidents. Due allowance is to be made, so far as the abnormal is concerned, for the patent

difficulty of framing regulations that avoid, on the one hand, being too oppressive, and, on the other hand, defy evasion and circumvention; and the better course is to trust to measures being finally worked out to prevent them from within rather than to arbitrarily and impetuously impose them from without. The wise man will find more hope in what the Governing Committee can accomplish than in drastic emergency legislation.

IV.

Speculation.

The fact that a considerable volume of the transactions on the Exchange is speculative in character is not a just ground for criticising the Exchange, its organization or management.

We do not propose to discuss the general subject of speculation at length or in detail. It is an old theme with economists, financiers and moralists, and there is nothing new to be said about it. Like all other activities on a large scale it has its good and its bad side, and all that is attainable is the correction of the latter in so far as it can be accomplished without impairing its necessary, useful and beneficent function. That is the object of many of the rules of the Exchange to which we have referred, and the only practical question is whether it is blamable for not having gone far enough in that direction, and if it is, whether the most effective cure is not to be found in action by the Exchange. A few general observations may not be amiss to relieve the subject from misconceptions and exaggerations, and the prejudices they engender. They will help at any rate to substitute

actual facts and conditions for general and undiscriminating impressions.

In the year 1912 the par value of the stocks listed upon the Exchange was about thirteen billion (13,000,000,000) dollars, and the par value of the stocks bought and sold was substantially the same. Thus, in the course of a year, the number of shares of stock bought and sold was substantially the same as the number of shares of stock listed.

The aggregate value of the bonds listed upon the Exchange in 1912 was about thirteen billion (13,000,000,000) dollars, and the total amount of bonds bought and sold was only six hundred and seventy-four million (674,000,000). Speculation in bonds on the Exchange is, therefore, a negligible quantity.

Even in the case of stocks in which the trading is quite extensive it does not follow that the great bulk of the trading is of a speculative character. Temporary investments and changes of investments account for a considerable volume of dealings. It is also a well known fact that there is a large volume of stocks that are not transferred on the books of the companies issuing them even in the case of purchases for other than speculative purposes. Let us assume, however, that, in the case of stocks which are bought and sold several times over in the course of a year, the bulk of the trading is of a speculative character. The stocks that are the subject of such speculation may be the stocks of enterprises yielding returns that fluctuate widely from year to year; or they may represent enterprises in process of development, the normal value of which for investment purposes has not been fixed, and which, therefore, are traded in upon the basis of their prospective value rather than their current value for investment purposes.

Speculation in stocks, taken as a whole, is a process by which the risk of loss and the chance of profit in corporate enterprises is divided up among the speculative community during the period that elapses between the floating of the

enterprises and the time when their securities attain a fixed and permanent investment value.

The originators of a great many sound enterprises would be unable to carry them without assistance until their securities attained a permanent investment value, and they have to depend upon the fact that the speculative community is ready to carry all, or a part of, the securities over this period. As the securities become more and more stable they pass from less conservative to more conservative hands, until at last most of them are held by permanent investors. When comment is made upon the amount of money which is being constantly loaned by the banks and others for the purposes of stock speculation, the greater part of it being loaned upon call, the fact is too generally overlooked that this money so loaned is to an appreciable extent the safe proportion of money employed in carrying enterprises of the country over the early period of their development.

The speculators in stocks, who in the main make up the speculative community to which we have referred, trade in securities as merchants trade in commodities; that is to say, they buy in the expectation of selling at a higher price for their profit, differing in this from investors, who look for their profit to the return from the securities in the shape of income. Trading in stocks and other securities as such is just as legitimate as any mercantile business. The traders who base their transactions on the study of the properties represented by the securities in which they deal, and their knowledge of the inherent value of the securities derived from such study, are usually the most conservative of the dealers in securities. The traders who look for quick profits in slight changes of market prices arising from fluctuations in the condition of the money market or other causes, which they watch closely with a trained eye, carry on their operations through perfectly legitimate and lawful transactions.

The tendency of the free play of speculation is to provide a

broad, open, active market and to keep the price of a security somewhere around its true value; at least, somewhere around the average value put upon it by the judgment of those who are interested in it and have a knowledge of the facts relating to it. A security is, of course, subject to constant fluctuations above and below the true value; but the dealings of the speculators who are disposed to purchase whenever it falls below the true value and to sell whenever it goes above, have a strong tendency to bring it back to and keep it around its true value under existing conditions.

The elimination of speculation by law, if that were possible, would result in periods of extraordinary inflation of prices followed by their rapid fall and disastrous panics.

It is said that there is much speculation by people who know nothing of inherent values and market conditions, and who do not apportion their commitments to their resources. That will be true as long as human beings are free agents. There may be safeguards against it, but there cannot be absolute prevention unless all speculation is sought to be prevented, which, as we have seen, is undesirable even if it were attainable. The difficulty in dealing with this problem is that whether a particular transaction of a particular individual is in fact legitimate speculation or not is known only to himself, for it depends upon his study of the situation, the degree of his knowledge, the extent of his resources in comparison with the risk that he undertakes, and other matters that he alone can know. There is no way of discriminating by rules or regulations between legitimate and reckless speculation, or of applying them if they could be formulated, for the reason that general rules must deal with all men alike, and not with the particular motives or condition of the individual. The matter may be put in this way: The right to buy and sell securities is just as much an inherent right as the right to buy and sell any other commodity. This right

can be exercised unwisely and recklessly ; but there is no way of prescribing by law or rule that a right may be exercised wisely but may not be exercised unwisely. The possession of the right carries with it the possibility of its unwise exercise.

We close this discussion with a pertinent quotation from the convincing and lucid article by Professor Emery on " Should speculation be regulated by Law," in the " Journal of Accountancy," for April, 1908.

> " Speculation in securities is bound up in the closest way with the whole matter of the investment of capital and the accumulating of the necessary means for carrying out great industrial enterprises. Just in so far as the stock market has a speculative clientele, it becomes an open and broad market and facilitates the disposal of great issues of stocks and bonds which are necessary for the carrying out of the industrial undertakings of the present age.
>
> " The limitation of this broad market must invariably prove a hindrance in the financing of the most legitimate enterprises, and all interference with the freedom of speculation must inevitably lessen openness of the market. If we attempt to secure the benefits, while restricting the evils of speculation, through discriminating against certain kinds of transactions, we find it impossible to really discriminate in any way according to the form of the transactions, while, inevitably, by restricting the forms of commerce and of commercial methods, we put a severe handicap upon entirely legitimate enterprise. There is only one way in which speculation can be stopped altogether, and that is by giving up the system of private property and adopting the Socialistic state.
>
> " It will be seen then that speculation is not a product of stock and produce exchanges. Speculation existed long before them, and it was only when speculation from natural causes became more and more important that men engaged chiefly in speculative trade formed organizations in order to adopt a general system of rules for the conduct of such business.

"The real cause then of the modern exchange in modern speculation is to be found, so far as commodities are concerned, in the marvelous improvements in the method of transportation and communication which have made the market for staple commodities a world market, in which prices are determined by the condition of supply and demand of many different sections separated by thousands of miles.

"So far as speculation in stocks is concerned this has been the inevitable result of the enormous multiplication of securities, due to the extension of corporate methods to business, which in itself is the result of huge modern enterprises demanding contributions of capital from a large number of small investors. The material progress of the last half century would have been impossible without such investment. Such investment would have been impossible without the multiplication of such securities of varying values, and the multiplication of such securities inevitably brings about speculation.

"Speculation, even on the part of the public, with all its evils, has a very important beneficial effect. Unless the public speculates to some extent the market will not only be very restricted but will be in consequence much more open to manipulatien. The bigger and broader the market the less chances there are for rigging prices. It may seem a very high price to pay for the open market that the speculative spirit should continue on the part of the public, but it would be a mistake to suppose that speculation can be confined to a few great operators and still offer the benefit which the present market gives.

"From a study of the effects of speculation and the effects of all suggested methods of controlling it, the conclusion is almost irresistible: that legitimate and illegitimate transactions are so closely bound together, and the whole business of speculation is so closely connected with the interests of actual commerce, that any interference with the delicate machinery by the blundering fingers of the law will diminish the beneficial elements of speculation without effectively diminishing its evils.

V.

Manipulation.

Manipulation is a term which in itself has a sinister implication. It is applied to a mass of transactions which differ in their purpose and nature, with the result that this sinister implication of the term subjects them to wholesale condemnation. It has been so emphasized as to create the impression that it comprehends a vast mass of the transactions on the Exchange. This is as unjust as it is prejudicial. It is to this loose use of words and phrases that the deplorable tendency of the times to heap undiscriminating obloquy on our important business and financial institutions is largely attributable. It is necessary, therefore, to differentiate the transactions to which the term is applied in order to determine to which of them it is properly applied; and then to differentiate the transactions to which it is properly applicable.

(*a*) Evidence was produced that the stocks of a few companies had been bought and sold many times over in the course of a single year. That fact may be entirely due to speculation, with which we have dealt, and not at all to manipulation in any proper sense of the term. Any activity of a stock from purely natural causes tends to develop speculation, and particularly the form of it which seeks to realize quick profits from slight changes in price. Arbitrage dealings between New York and London and other markets assume very large proportions, traders buying in one market and selling in another in order to profit by slight differences in the prices prevailing in the different markets. Stocks are daily bought in great quantities, to be sold quickly on slight variations of price. These transactions attain to a large volume; and are accompanied by comparatively few transfers

on the books of the companies as the stock certificates endorsed in blank pass from hand to hand. Hence volume of trading due to ordinary speculation is not to be confounded with manipulation, or treated as manipulation in any sense. The fact is that the transactions for investment and for ordinary speculation comprehend the great bulk of the transactions on the Exchange.

(*b*) We will roughly define "manipulation", for the purposes of this argument, as the creation of activity in a stock, by buying and selling orders emanating from the same man or group of men, to make a market for the stock, or to raise or lower its price in the expectation of a speculative profit. These are the transactions of which we have said that their volume is a very minor quantity as compared with the transactions for the purposes of investment or ordinary speculation. The forms of manipulation as thus defined vary in essential matters and require further analysis.

(1) Such dealings in a new stock conducted in good faith to make a market for it at its true value, or what is believed to be its true value, are claimed by eminent authorities to be legitimate and necessary.

This form of manipulation involves the execution of selling and purchasing orders given in the same interest under such conditions that the actual transfers of title may be less than the apparent volume of transactions upon the floor. One view to take of it is that suggested in the course of the examination of various witnesses; *i. e.*, that it represents a stock as active, which is, in fact, inactive, and that its purpose is to mislead in somewhat the same way as a mock auction. The other view is that, so long as the offers to buy and the offers to sell are *bona fide* offers which any one who chooses may accept, they are actual indications of market conditions; that is to say, of the price at which the stock in question can be bought and sold.

The Hughes Commission said of this form of manipulation :

> " The first kind of manipulation has certain advantages, and when not accompanied by ' matched orders ' in unobjectionable *per se*. It is essential to the organization and carrying through of important enterprises, such as large corporations, that the organizers should be able to raise the money necessary to complete them. This can be done only by the sale of securities. Large blocks of securities, such as are frequently issued by railroad and other companies, cannot be sold over the counter or directly to the ultimate investor, whose confidence in them can, as a rule, be only gradually established. They must therefore, if sold at all, be disposed of to some syndicate, who will in turn pass them on to middlemen or speculators, until, in the course of time, they find their way into the boxes of investors. But prudent investors are not likely to be induced to buy securities which are not regularly quoted on some exchange, and which they cannot sell, or on which they cannot borrow money at their pleasure. If the securities are really good and bids and offers *bona-fide*, open to all sellers and buyers, the operation is harmless. It is merely a method of bringing new investments into public notice."

The question whether such manipulation is legitimate in any particular case must depend upon whether the transactions have a tendency to mislead. When the persons conducting the transactions confine themselves to buying from, and selling to, others than themselves, thus furnishing a market for those who wish to buy or to sell, we are unable to see any just grounds for criticism. If, however, they give out orders in such a way that transactions do not result in a real change of ownership, although the offers to purchase and sell are made in the open market where anybody is free to accept them and actual delivery between brokers is made, there is a question which is engaging the serious consideration of the Exchange

whether such transactions may not have a tendency to mislead, and should not be treated as fictitious whenever members of the Exchange participate in them with knowledge of their true character.

(2) Another form of manipulation is described by the Hughes Commission as follows :

> "That which is designed to serve merely speculative purposes in the endeavor to make a profit as the result of fluctuations which have been planned in advance."

Of it the Commission says :

> "The second kind of manipulation mentioned is undoubtedly open to serious criticism. It has for its object either the creation of high prices for particular stocks, in order to draw in the public as buyers and to unload upon them the holdings of the operators, or to depress the prices and induce the public to sell. There have been instances of gross and unjustifiable manipulation of securities, as in the case of American Ice stock. While we have been unable to discover any complete remedy short of abolishing the Stock Exchange itself, we are convinced that the Exchange can prevent the worst forms of this evil by exercising its influence and authority over the members to prevent them. When continued manipulation exists it is patent to experienced observers."

This is one of the most difficult and complex problems with which the Exchange has had to deal. It is vastly more complex than the description of it seems to indicate. The plan or scheme which that form of manipulation involves is most likely to be a plan or scheme of persons outside the Exchange over whom it has no jurisdiction, which is worked through orders to different unconnected brokers that do not differ from the usual orders of customers to their brokers. A broad prohibitive rule would have no efficacy in that case because of the innocence of the

brokers. The natural effect of any dealings on a large scale is to produce a fluctuation in prices, and it is difficult to draw the line between an adjustment of buying and selling orders which constitutes legitimate speculation and such an adjustment which would bring the transaction as a whole within the definition of improper manipulation. The danger of any rule to meet this form of manipulation, however carefully it may be framed, is that it is likely to bring within its scope perfectly legitimate transactions and thus curtail the usefulness of the Exchange. So far the efforts to frame a specific rule of that kind have not produced one which has commanded sufficient approval to warrant its adoption. There has been a natural and wise disinclination to enact a rule, in addition to the existing rules, to reach a sporadic evil which would also continuously restrict legitimate dealings. It is to be borne in mind that what there is of the evil is sporadic, and that the officers of the Exchange see it in its true proportion, which is very different from the proportion popularly assigned to it through misinformation.

(c) Existing rules and practices of the Exchange in restraint of manipulation are :

First. The requirements of the Listing Committee that no stock shall be admitted to dealings upon the Exchange until it has been sufficiently distributed for an open market.

Second. The powers of the Governing Committee and the Stock List Committee to strike securities from the list or to suspend dealings in securities.

Third. The provision of the Constitution prohibiting fictitious transactions, including "matched" orders and "wash" sales.

Fourth. The rule which, in its present form, was adopted in 1910 pursuant to the suggestions of the Hughes Commission, and which provides (pages 76–77), that "all bids and offers on larger lots shall be considered to be for any part thereof in lots of 100 shares or multiples thereof, and

if a bid is made for a larger lot of stock above the price at which smaller lots are offered, or if a transaction is made in a larger lot above the price at which smaller lots are offered, such bidder or buyer shall be compelled to buy any or all of the smaller lots which were publicly offered at the time, at the lower price, up to the amount of the bid for the larger lot;" and similarly as to offers to sell.

These rules are rigidly enforced, and experience has demonstrated them to be an effective restraint on improper manipulation, though not to the point of absolute prevention. They accomplish so much that they cannot be ignored and should not be belittled. They have eliminated improper manipulation on any scale *as a common practice.* The problem now is to prevent even occasional operations of the kind. In our judgment more dependence is to be placed on the Exchange itself working out a solution than upon any statute that can be drawn.

The Governing Committee has been for some time past, and is now, considering the whole subject of manipulation to determine whether further prohibitory rules and provisions with respect to it can be effectively framed.

VI.

Short Sales.

We believe that much of the disapprobation with which the short selling of stock is regarded by many people would be removed by a clear understanding on their part of just what it is. Contracts for the sale of securities made on the Exchange contemplate the delivery of the securities and payment therefor on the day subsequent to the day of the contract, and this is true whether the sales are short sales or sales of securities in hand. A broker receives from his prin-

cipal an order to sell a hundred shares of stock. In the execution of this order he makes a contract to sell and deliver the stock, delivery to be made on the following day and payment in full to be made at the same time. In the simplest case the customer has the stock and furnishes it to the broker before the time for delivery under the contract of sale. In all other cases the sale is a short sale.

The customer may be away from New York and his stock may be in a safe-deposit box to which access cannot be obtained until his return. He may live in London, so that many days will elapse before it can be delivered in New York. It may be pledged in a bank, so that it cannot be obtained until a loan is paid off. He may not own the stock, but may be entitled to get it later under a subscription contract or underwriting agreement, or some other sort of executory contract. Lastly, he may not own the stock or have any contract entitling him to receive it, but may have made the sale because he knows that he can buy the stock later and believes than he can buy it at a lower price.

In all these cases the broker provides the stock with which to make delivery to the purchaser, and the customer sooner or later returns to the broker the amount of stock so advanced. He may do this as soon as he chooses; he must do it after reasonable notice from the broker so to do. He may furnish it from shares that he has had all the time in his safe-deposit box, or that have reached him from abroad, or that he has received under a contract, or that he has bought since the sale.

The short sale in which the seller does not have the stock but expects to buy it later is the sort that is sometimes criticised. But the general view of courts and economic writers is that it is entirely legitimate.

The Court of Appeals of New York says in *Hurd vs. Taylor, 181 N. Y., 231:*

> "The purchase of stocks through a broker, though the party ordering such purchase does not intend to hold the stocks as an investment, but expects the broker to carry them for him with the design on the part of the purchaser to sell again the stocks when their market value has enhanced, is, however speculative, entirely legal. Equally so is a 'short' sale, where the seller has not the stock he assumes to sell, but borrows it, and expects to replace it when the market value has declined."

In *Bibb vs. Allen, 149 U. S., 481,* the Supreme Court of the United States says :

> "It is well settled that contracts for the future delivery of merchandise or tangible property are not void, whether such property is in existence in the hands of the seller or to be subsequently acquired."

The Court quoted with approval the charge of the trial Court in *Irwin vs. Williar, 110 U. S., 499,* which was in part as follows :

> "A person may make a contract for the sale of personal property for future delivery which he has not got. Merchants and traders often do this. A contract for the sale of personal property which the vendor does not own or possess, but expects to obtain by purchase or otherwise, is binding if an actual transfer of property is contemplated."

The Hughes Commission in its report said in reference to short selling :

> "We have been strongly urged to advise the prohibition or limitation of short sales, not only on the theory that it is wrong to agree to sell what one does not possess, but that such sales reduce the market price of the securities involved. We do not think that it is wrong to agree to sell something that one does not

now possess, but expects to obtain later. Contracts and agreements to sell, and deliver in the future, property which one does not possess at the time of the contract, are common in all kinds of business. The man who has 'sold-short' must some day buy in order to return the stock which he has borrowed to make the short sale. Short-sellers endeavor to select times when prices seem high in order to sell, and times when prices seem low in order to buy, their action in both cases serving to lessen advances and diminish declines of price. In other words, short-selling tends to produce steadiness in prices, which is an advantage to the community. No other means of restricting unwarranted marking up and down of prices has been suggested to us."

These views accord with the weight of authority among economists, and their further elaboration is unnecessary.

Legislation to limit the short selling of securities is undesirable and it would be ineffective. Whenever the prices of securities reach a point where men believe that they can make a profit by selling them they will make such sales, and no legislation can prevent them from so doing. Such legislation might drive the business away; but the markets of Paris, Montreal, and, above all, the London market, would be open to it. As between the markets where short selling is permitted and markets where it is prohibited, the former will be the predominant markets and draw to themselves from the latter much of their business and of the capital employed in it. This was the experience of Germany in her attempts to prohibit short selling; and the same results would follow from any similar attempt made here.

VII.

Hypothecation.

It has been made a subject of criticism that the Exchange has no rule regulating the use by its members of the securities carried by them for their customers.

The Exchange has not undertaken in its constitution to set out the law of principal and broker, or to define the rights of a broker in respect to his customer's securities. The rights of the parties in respect to such matters are fixed by the law of the land, and it would be impracticable to reproduce the rules of which that law consists in the rules of the Exchange.

The notion that the Exchange has been remiss with respect to the dealings of its members with the securities of their customers in pledging them to raise the money with which to carry them for their customers is based upon a misconception of the relations of the Exchange to those dealings. The transactions of purchase and sale take place on the Exchange and are governed by its rules. When they are completed and the stocks bought are delivered they are held by the broker for his customer. What he may then do with them is not a matter which the Exchange can determine, because it depends upon the terms of any arrangement he may have with the customer, or, in the absence of any such arrangement, upon his legal rights. The Exchange has no knowledge of those arrangements, and no authority over the legal rights of the broker. Generally speaking, the legal right of the broker is to pledge the stocks for the amount his customer owes on them. There is authority for saying that he has the further right to pledge the stocks of different customers in mass for a single loan. (Mayer vs. Monzo, 151 App. Div., 866). The customer may enlarge these rights, as is the usual course. Everything depends so much upon the arrangements and

relations between the broker and his customer and what the course of dealing may have been between them that it is apparent that the Exchange has but little, if any, power or opportunity of intervention or control.

If any member of the Exchange, in dealing with the securities of his customer, is guilty of improper conduct he is, upon its discovery, subject to the penalty of expulsion under the rules which have been already cited. The Exchange cannot act until the fact has been made known by a default or other disclosure, unless it employed a numerous body of examiners to continuously scrutinize the transactions of all of its active members, including their books and the securities pledged for their loans; and, in addition, ascertained in some way or other what were the arrangements between the members and their customers. It is obviously impracticable for the Exchange to exercise such a function; and there is absolutely no occasion for it, as is demonstrated by the fact that the losses from any misuse of securities compared with the total volume of the transactions are infinitesimal. The criticism of the Exchange on this ground is without any reasonable basis.

VIII.

Particular provisions of the constitution and rules of the Exchange.

(a) The minimum rate of commission. The suggestion that this regulation is a restraint upon interstate commerce in violation of the Sherman Anti-Trust Act, is answered by the cases cited under Point I.

The Exchange has fixed the rates to be charged by its members at what it deems to be fair compensation. To permit

its members to charge less than a fair rate would result in secret rebates and concessions to large customers; and might induce members, in the struggle for business, to offer concessions which they could not afford. So far as the public is concerned it would tend to the advantage of the large as against the small or occasional customer. The members of the Exchange, like members of the professions, compete for business with one another by each one endeavoring to establish for himself a reputation for business judgment, conservatism and rectitude, and not by the commission they charge.

(b) Limitation of membership. Any criticism of the limitation of membership to eleven hundred (1,100) would seem to be fanciful. If the membership is at any time not sufficient to transact the business either the membership must be increased or the business will go elsewhere. The membership has never in fact proved insufficient.

(c) The rule prohibiting members from belonging to other Exchanges in the City of New York which permit the trading in securities that are also dealt in upon the Exchange. The sufficient reason for this rule is that the Exchange deems it reasonable and proper that its members should not belong to Exchanges that directly compete with it as markets for business. As its members enjoy the benefit of the market it affords each member should contribute his business to that market rather than to a rival Exchange.

(d) Relations to Consolidated Exchange. The whole question as to the relations of the Exchange to the Consolidated Exchange was involved in the case of *Heim vs. New York Stock Exchange*, the opinion in which has been handed to the Committee. The court considered the rule prohibiting the members of the Exchange from transacting business for active members of the Consolidated Exchange and held that it was entirely reasonable.

(e) Preference of members. The rule of the Exchange to the effect that upon the insolvency of a member the proceeds of his membership shall be applied first to the payment of debts due to other members is just and reasonable. The value of each membership is in effect pledged by the member to his fellow members to secure his performance of any obligations into which he may enter with them. The purpose of this mutual pledge is to enable the members to deal freely with each other. Business between the members is immensely facilitated by the rule, because, without it, it would be very difficult to maintain the other rule whereby a member is bound to close a contract with the member who first accepts his bid or offer; that is to say, which prevents members from choosing with whom they will trade among their fellow members. This system, which takes away from the members of the Exchange the right to select those with whom they will contract, is necessary to the maintenance of an open market.

IX.

Striking securities from the stock list.

The Exchange was called upon in this investigation to furnish a list of all the securities stricken off the list over a long period of years and the amount of stock in each corporation stricken from the list that was at the time outstanding in the hands of minority interests. The list furnished by the Exchange shows that the Exchange never strikes a security from the list so long as a substantial proportion of the stock is outstanding in the hands of the public.

There is danger in allowing a stock to remain on the list when only a small proportion of it is outstanding because of the temptation to ingenious manipulation. For this reason the

Exchange refuses to list a security so long as the greater part of it is owned by a single interest. The same reason requires that it should be stricken from the list when only a small proportion remains in the hands of the public. The testimony of Mr. Mabon and Mr. Pomroy shows further that the striking of securities from the list under these circumstances works no injury to the minority holders. The exchangeability of this minority interest under the terms of an agreement of consolidation or merger insures for it an immediate market value for purposes of sale or for use as collateral security; and, as has been shown, there is no difficulty either in selling a security, or in borrowing upon it, outside of the Exchange.

We submit that the evidence conclusively shows that the power to strike securities from the list has not, in fact, been used so as to coerce the owners of minority interests; and the composition of the Governing Committee of the Exchange furnishes the strongest sort of guarantee that it will never be so used.

X.

The New York Bank Note Co.

Representatives of the New York Bank Note Company have been allowed to appear as witnesses and have made the charge that the Exchange in refusing to list the securities engraved by the New York Bank Note Company is actuated by the desire to promote the interests of the American Bank Note Company.

In a case which has long been pending in the Federal Court in the Southern District of New York the same charge made by the New York Bank Note Company is denied by the Exchange. The reasons of the refusal of the Exchange to

list securities engraved by the New York Bank Note Company as set out in its answer to that suit are as follows :

" Since the organization of the New York Stock Exchange said Exchange has admitted to the list of securities that may be dealt in on the floor of the Exchange by its members only such securities as said Exchange has judged it proper so to admit, and has required that issues of securities sought to be listed upon the Exchange should be engraved, and has made such requirements in respect to the engraving thereof as in the judgment of the Exchange were necessary or proper to prevent the forgery of securities dealt in on the Exchange, or the improper use of the plates used in engraving such securities, and to insure that all of such securities in respect to engraving, paper, ink, printing and in all other details should conform to the standard sought to be maintained by the Exchange in respect to securities listed upon said Exchange.

" Ever since a period long prior to the times mentioned in the amended complaint the Exchange has deemed it necessary for the purposes aforesaid to require that securities sought to be listed upon the Exchange should be engraved by engraving companies whose qualifications in respect to financial responsibility, character of direction and management, general features and quality of workmanship, general methods of business, and in all other respects were such in the judgment of the Exchange as to furnish a reasonable assurance that the securities engraved by them would conform to the standard sought to be maintained by the Exchange, and that forgery and misuse of plates would be prevented, and, therefore, the Exchange has required that the securities of all issues sought to be listed upon the Exchange should be engraved by companies whose qualifications have been approved by the Exchange.

" The New York Bank Note Company was organized under the laws of West Virginia in the year 1892, and at various times since its organization has applied to

the New York Stock Exchange to have its qualifications approved by said Exchange, and its representatives have from time to time appeared before the authorities of the Exchange and have been accorded hearings in respect to the qualifications of said Company, but, in the judgment of the Exchange, said Company has failed to show that its qualifications were such as to justify the approval thereof by the Exchange and that the Exchange has not approved said Company or authorized the Committee on Stock List to pass upon securities engraved by said Company. For the reasons aforesaid no securities engraved by the plaintiff have ever been admitted to the stock list of the New York Stock Exchange, and the Committee on Stock List has refused to pass upon specimens of the plaintiff's engraving work."

For several years prior to the year 1892 securities engraved by the New York Bank Note Company of *New Jersey* were admitted to the Stock List. The manager of the Company was George H. Kendall, who is now president of the New York Bank Note Company of *West Virginia*. The experience of the Exchange with the New Jersey Company under Kendall's management was very unsatisfactory. In 1892 the New Jersey Company went out of business and the New York Bank Note Company of West Virginia was organized. All or substantially all of its stock has always been owned by Kendall. It has a capital of ten thousand ($10,000) dollars divided into ten thousand shares of one ($1) dollar each. No securities engraved by it have ever been admitted to the Stock List.

In 1892 and for many years thereafter there were, besides the American Bank Note Company, several engraving companies entirely independent of the American whose work was admitted to the Stock List. These companies were eventually acquired by the American. Since they were so acquired the Stock List Committee has been authorized to pass upon the work of other companies which are entirely independent of the

American, and there are now four such companies whose work is admitted to the Stock List.

Stock of the American Bank Note Company held from time to time by members of the Exchange for their customers often stands in their names. A few members in no way connected with the management of the Exchange own some of the stock, amounting in the aggregate to a small fraction of the total issue.

The suggestion that the forty members of the Governing Committee of the Exchange, who represent the interests of its eleven hundred members and are elected by, and are responsible to, those eleven hundred members, have excluded securities from the Stock List for the purpose of advancing the personal interest of half a dozen members who happen to own a small part of the stock of the American Bank Note Company, is too absurd for serious consideration.

XI.

The Exchange is not dominated by any individuals or groups of individuals as recited in the resolution authorizing this investigation.

The powers of the Exchange have never been used for the promotion of any private interest or for the special advantage of any particular individual or group of individuals. These powers have been exercised solely with a view to the interest and welfare of the Exchange and the promotion of the purposes set forth in its constitution.

The Exchange has no special relations to the persons and groups referred to in the resolution of Congress or to their financial transactions; and its only relation to the financial

and commercial system of the country is that it is the place where a great proportion of the trading in securities is carried on.

Because the Exchange is a great market for active securities the first symptoms of business distrust and disturbance become apparent upon its floor. Though it is a fact that a large volume of securities is carried on call loans obtained from the banks and that the first symptom of a stringency in the money market is the rise in the rate of call money, the responsibility for the conditions that bring about a recurrent stringency in the money market does not rest upon the traders in securities or the Exchange. They are due to the non-elasticity of our currency system and the fact that its volume continues substantially the same irrespective of the demands of business. But we will refrain from entering upon a discussion of the currency system of the country if for no other reason than that this brief is already too long.

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